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Fiduciary Rule Creates Breach of Contract Claim, But No Private Right of Action

By John I. Sanders

The first part of the DOL's Conflict of Interest Rule (the "Fiduciary Rule") went into effect on Friday, June 9th. A large group of newly-defined "fiduciaries" are now subject to certain requirements of the Best Interest Contract ("BIC") exemption, [1] a portion of the Fiduciary Rule that according to some commentators creates a private right of action for investors. The creation of a private right of action is one of the investment industry's chief concerns with the Fiduciary Rule. Industry leaders claim that the BIC exemption creates a private right of action because it enables investors to bring breach of contract claims and class actions against the fiduciaries with whom they contract. However, a federal judge from the Northern District of Texas flatly rejected this claim in *Chamber of Commerce of the United States of America v. Hugler*. [1] The plaintiff in *Hugler* claimed, among other things, that the BIC exemption created a private right of action in violation of *Alexander v. Sandoval*, a Supreme Court case holding that only Congress, not an administrative agency, can create a private right of action under federal law. [2] But the judge in *Hugler* sided with the DOL, finding that the BIC exemption does not create a private right of action, and so does not violate *Sandoval*. [3] The judge reasoned that any lawsuit resulting from the breach of a BIC exemption contract would be brought under state contract law rather than federal ERISA law. [4] The judge also noted that it is not a new concept for federal regulations to require entities to enter into written contracts with mandatory provisions; annuity owners already have enforceable contract rights against insurers, and multiple other agencies require that their regulated entities enter into written agreements with mandatory terms. [5] Yet articles from leaders in the legal and investment industries continue to label the BIC exemption's litigation risk as a private right of action for investors. Fiduciaries reading these articles should keep in mind that a private right of action cannot exist under the BIC exemption because the Supreme Court's ruling in *Sandoval* only allows a private right of action to be created by Congress. Also, it is unlikely that any court will block the Fiduciary Rule on the grounds that the BIC exemption impermissibly creates a private right of action because, as pointed out by the judge in *Hugler*, any claims brought as a result of BIC exemption contracts would be brought under state law rather than federal law. However, fiduciaries should be aware that the Fiduciary Rule still exposes them to litigation risk as investors can use BIC exemption contracts (which are not required to be used until January 1, 2018) to file state breach of contract claims and, potentially, class actions. **John I. Sanders** is an associate based in the firm's Winston-Salem office. [1] For more information on current Fiduciary Rule and BIC Exemption requirements, see Paul Foley & John Sanders, *DOL Puts Advisors on Notice: Fiduciary Rule Will be Effective June 9th*, Kilpatrick Townsend: Inv. Mgmt. Blog (May 25, 2017, 9:32 PM), <http://blogs.kilpatricktownsend.com/investmentmanagement/?p=321>. [1] *Chamber of Commerce of the United States of Am. v. Hugler*, 3:16-CV-1476-M, 2017 WL 514424 (N.D. Tex. Feb. 8, 2017). [2]



Alexander v. Sandoval, 532 U.S. 275, 286 (2001) (citing *Touche Ross & Co. v. Reddington*, 442 U.S. 560, 578 (1979)). [\[3\]](#) *Hugler*, 3:16-CV-1476-M, 2017 WL 514424, at *20. [\[4\]](#) *Id.* [\[5\]](#) *Id.*